

Message Text

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ACTION ARA-10

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-03
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FM AMEMBASSY PANAMA

TO SECSTATE WASHDC 0672

INFO USSOUTHCOM

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GUATEMALA FOR ROCAP

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TAGS: ECON, EFIN, PN

SUBJECT: GOP ENACTS MEASURES TO SPUR ECONOMY

REF: A. PANAMA 0047 (NOTAL; B. PANAMA 8607 (12/22/76);

C. PANAMA 7225 (10/20/76)

1. SUMMARY: SEVERAL LAWS WERE RECENTLY ENACTED BY THE GOP TO PROMOTE PANAMA'S ECONOMIC RECOVERY AND STRENGTHEN ITS FISCAL STRUCTURE, THROUGH STIMULANTS TO PRIVATE INVESTMENT AND INCREASES IN CONSUMER TAXES. THE PRINCIPAL MEASURES WERE LABOR CODE CHANGES FAVORABLE TO EMPLOYERS AND A 5 PERCENT VALUE ADDED TAX ON ALL MERCHANDISE EXCEPT FOOD, MEDICINE AND FUEL. REACTION WITHIN THE BUSINESS COMMUNITY VARIED, BUT TYPICALLY THE INVESTMENT INCENTIVES WERE VIEWED AS MOVES IN THE RIGHT DIRECTION THAT WILL HAVE A POSITIVE ALTHOUGH FAIRLY MINOR IMPACT ON THE ECONOMY. WE SEE THEM AS NEEDED STEPS TOWARD THE EVENTUAL RE-

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JUVENATION OF PANAMA'S ECONOMY BUT NOT SUFFICIENT BY THEMSELVES TO GET THE ECONOMY ROLLING AGAIN. ALSO, ESTIMATED REVENUE INCREASES OF \$27 MILLION ANNUALLY FROM THE NEW TAX MEASURES APPEAR TO BE OVERLY OPTIMISTIC FOR 1977, SINCE DIFFICULTIES IN SETTING UP COLLECTION PROCEDURES FOR THE 5 PERCENT TAX ARE LIKELY TO DELAY FULL IMPLEMENTATION WELL BEYOND THE MARCH 1 EFFECTIVE DATE. THE OVERALL PACKAGE WAS POLITICALLY HAZARDOUS

SINCE IT HURT LABOR AND THE CONSUMING PUBLIC, WHO HAVE BEEN PREDICTABLY EMBITTERED OVER THE ADDED HARDSHIPS THE MEASURES WILL IMPOSE. HOWEVER, THEY REPRESENT A GOP DETERMINATION TO REMOVE OBSTACLES TO RENEWED ECONOMIC GROWTH, PARTICULARLY THROUGH INDUCEMENTS TO THE PRIVATE SECTOR TO MOVE BACK INTO THE FOREFRONT OF PANAMA'S ECONOMIC DEVELOPMENT PROCESS, DESPITE AN INCREASED ECONOMIC BURDEN ON THE GENERAL PUBLIC. END SUMMARY.

2. THE GOP PASSED 26 NEW LAWS IN LATE DECEMBER 1976 TO IMPLEMENT ITS RECENTLY-ANNOUNCED ECONOMIC RECOVERY PLAN (SEE REFTEL A). THESE MEASURES ARE AIMED SPECIFICALLY AT BOOSTING PRIVATE INVESTMENT, ESPECIALLY CONSTRUCTION, REDUCING UNEMPLOYMENT, EXPANDING EXPORTS, AND INCREASING GOVERNMENT REVENUES. THE TWO MOST IMPORTANT AND CONTROVERSIAL MEASURES ARE A) LABOR CODE CHANGES EASING FIRING RESTRICTIONS AND SUSPENDING COLLECTIVE BARGAINING FOR TWO YEARS, AND B) THE IMPOSITION OF A 5 PERCENT VALUE ADDED TAX. THE LAWS TAKE EFFECT JANUARY 1, EXCEPT FOR THE 5 PERCENT TAX WHICH IS EFFECTIVE MARCH 1.

3. THE LABOR CODE WAS CHANGED TO EASE EMPLOYEE DISMISSAL WITHOUT CAUSE BUT WITH TERMINAL PAYMENTS AS PREVIOUSLY, SO LONG AS THE TOTAL NUMBER OF EMPLOYEES REMAINS UNCHANGED. ALSO, DISMISSAL WITH CAUSE HAS BEEN MADE LESS RESTRICTIVE. COLLECTIVE BARGAINING IS BANNED FOR THE NEXT TWO YEARS. LABOR CONTRACTS WITH 1977 OR 1978 TERMINATION DATES ARE EXTENDED FOR TWO YEARS, AND NEW FIRMS AS WELL AS THOSE CURRENTLY WITHOUT LABOR CONTRACTS HAVE A TWO-YEAR GRACE PERIOD IN NEGOTIATING A CONTRACT. ARBITRATION OF LABOR DISPUTES (BY THE MINISTRY OF LABOR) IS NOW COMPULSORY LIMITED OFFICIAL USE

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IN THE EVENT OF STRIKE WHENEVER THE MINISTRY DETERMINES THAT THE NATIONS ECONOMIC WELL BEING WOULD BE AFFECTED.

4. OTHER NEW LAWS TO STIMULATE INVESTMENT INCLUDE AN EXTENSION OF THE PRESENT FIVE-YEAR REAL ESTATE TAX HOLIDAY TO TEN YEARS ON CONSTRUCTION BEGUN WITHIN THE NEXT 16 MONTHS, ACCELERATED DEPRECIATION ON CONSTRUCTION STARTED DURING 1977 AND 1978, AND A 90 PERCENT REDUCTION IN CORPORATE TAX ON EARNINGS REINVESTED WITHIN THE FIRST NINE MONTHS OF 1977. BENEFITS GRANTED UNDER EXISTING INVESTMENT INCENTIVE AGREEMENTS WITH THE GOP ARE EXTENDED TO TEN YEARS. A NEW STATE CORPORATION, INCLUDING BUDGET, IS SET UP TO CONTROL AND PROMOTE SYSTEMATIC DEVELOPMENT OF THE BAYANO REGION, ENVISIONING PRIVATE AS WELL AS PUBLIC PARTICIPATION IN ITS DEVELOPMENT.

5. TO EXPAND EXPORT EARNINGS, A RE-INSURANCE LAW WAS ENACTED TO ATTRACT AND GOVERN THE OPERATION OF RE-INSURANCE COMPANIES AND RE-INSURANCE BROKERS. BOTH FOREIGN AND DOMESTIC

OPERATIONS ARE ENVISIONED. ALSO, A COMMISSION WAS ESTABLISHED TO ADMINISTER THE INDUSTRY. ANOTHER MEASURE IMPROVES THE NEGOTIABILITY OF EXPORT TAX CREDIT CERTIFICATES (CAT'S) BY PERMITTING THE HOLDER TO USE THEM IN PAYMENT OF ANY TAX LIABILITY. MEASURES AIMED AT ENCOURAGING TOURISM INCLUDE TIGHTER REGULATIONS AND STANDARDS FOR THE TOURISM SECTOR, CHANGES IN THE TOURIST BUREAU (IPAT) ORGANIZATION, AND THE EARMARKING OF 10 PERCENT OF ALL TOURISM RECEIPTS FROM LODGING FOR THE TOURIST BUREAU.

6. SEVERAL TAX LAWS WERE ENACTED IN ADDITION TO THE MAIN 5 PERCENT VALUE ADDED TAX WHICH WILL BE LEVIED ON ALL MERCHANDISE TRANSACTIONS EXCLUDING FOOD, MEDICINE AND FUEL. A \$.15 PER LITER PRODUCTION TAX ON BEER WAS INTRODUCED AND TAXES ON THE PRODUCTION OR IMPORTATION OF LIQUOR AND CIGARETTES WERE INCREASED, ALONG WITH SOME OTHER MINOR DUTY INCREASES. PROPERTY VALUED AT LESS THAN \$10,000 WAS EXEMPTED FROM THE REAL ESTATE TAX. TOTAL NON-FARM EARNINGS OF \$1,000 OR LESS LIMITED OFFICIAL USE

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AND GROSS FARM INCOME OF LESS THAN \$25,000 WERE EXEMPTED FROM THE INCOME TAX. THE CORPORATE TAX RATE STRUCTURE WAS SIMPLIFIED WITHIN A 20-50 PERCENT SURTAX RANGE (INCLUDING ELIMINATION OF THE 10 PERCENT CATEGORY). AN ANNUAL REGISTRATION TAX OF \$50 WAS LEVIED ON ALL REGISTERED COMPANIES, BOTH FOREIGN AND DOMESTIC, BUT WHICH CAN BE CREDITED AGAINST THE FIRM'S INCOME TAX LIABILITY. ANOTHER MEASURE PROVIDES FOR IMPROVED TAX ADMINISTRATION AND CONTROL. A MEASURE TO ENCOURAGE EMPLOYMENT PROVIDES FOR A BUSINESS INCOME TAX CREDIT RANGING DOWNWARD FROM \$75 TO \$15 PER MONTH OVER A THREE-YEAR PERIOD FOR EACH NET ADDITION TO A FIRM'S WORK FORCE THAT TAKES PLACE OVER THE NEXT TWO YEARS.

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7. THE ABOVE MEASURES WERE DESIGNED AS AN ALL OUT ATTACK ON PANAMA'S CONTINUING RECESSION WHICH THE GOP NOW PERCEIVES AS BEING DEEP SEATED, INVOLVING STRUCTURAL PROBLEMS SUCH AS LOW PRODUCTIVITY, EXCESSIVE CONSUMPTION, AND A WEAK FISCAL STRUCTURE, ALONG THE LINES DESCRIBED IN REFTEL C). THE MEASURES ARE MULTIDIMENSIONAL. SHORT TERM STIMULANTS INTENDED TO GET THE ECONOMY MOVING AGAIN INVOLVE PRINCIPALLY INCENTIVES TO BOOST CONSTRUCTION ACTIVITY. THIS INDUSTRY IS NOT ONLY ESPECIALLY DEPRESSED, BUT THE EFFECTS OF AN IMPROVEMENT WOULD BE EXPECTED TO SPREAD QUICKLY TO OTHER SECTORS AS WELL AS TO ABSORB SUBSTANTIAL NUMBERS OF UNEMPLOYED. THERE IS A SIMULTANEOUS EFFORT TO ALSO SET THE BASIS FOR LONGER TERM EXPANSION OF PRIVATE INVESTMENT. THE GOP HOPES FOR A MAJOR IMPROVEMENT IN THE GENERAL BUSINESS CLIMATE FROM LABOR CODE CHANGES, WITH THE GREATER FLEXIBILITY IN EMPLOYEE DISMISSALS AND THE TWO-YEAR FREEZE ON COLLECTIVE BARGAINING EXPECTED TO STABILIZE COSTS, IMPROVE PRODUCTIVITY, AND IN GENERAL TO REMOVE WHAT THE BUSINESS COMMUNITY HERETOFORE HAS DEEMED A PRO-LABOR BIAS IN THE GOP'S HANDLING OF LABOR MANAGEMENT

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RELATIONS. THE RE-INSURANCE LAW IS MEANT TO OPEN UP NEW POSSIBILITIES FOR ATTRACTING EXCHANGE EARNING INVESTMENTS IN RE-INSURANCE OPERATION, AS AN ADJUNCT TO PANAMA'S ROLE AS A REGIONAL COMMERCIAL AND FINANCIAL CENTER, AND IMPROVEMENTS IN TOURISM REGULATION ARE EXPECTED TO ADVANCE THE PACE OF THAT INDUSTRY'S DEVELOPMENT. THE GOP ALSO HOPES THAT PRIVATE INVESTMENT WILL BE ATTRACTED TO THE BAYANO REGION NOW THAT A STATE ENTERPRISE HAS BEEN SET UP TO ADMINISTER ITS OVERALL DEVELOPMENT.

8. THE ADEQUACY OF THE INVESTMENT INCENTIVES CAN ONLY BE LOOSELY JUDGED SINCE NO SPECIFIC TARGETS OR TIMETABLES WERE SET. INVESTOR RESPONSE TO LABOR CODE CHANGES WILL DEPEND BASICALLY ON THE EXTENT TO WHICH IT IS ADMINISTERED WITH LESS PRO-LABOR BIAS THAN FORMERLY SINCE BOTH THE RIGHT TO STRIKE AND THE EXPANDED RIGHT TO FIRE EXIST ONLY AS AUTHORIZED BY THE LABOR MINISTRY IN ITS INTERPRETATION OF THE REVISED LAW. ALL OF THE OTHER INCENTIVES WERE EITHER OF A RELATIVELY MINOR NATURE OR DESIGNED FOR THE

LONGER TERM. INITIAL REACTION AMONG BUSINESSMEN RANGES FROM A RELATIVELY INDIFFERENT, WAIT-AND-SEE ATTITUDE TO THE MORE PREDOMINANT VIEW THAT THE MEASURES, WHILE NOT SUFFICIENT, REPRESENT PROGRESS IN RESTORING INVESTOR CONFIDENCE AND COULD HAVE A POSITIVE EFFECT ON THE ECONOMY. WE SEE THE MEASURES AS NEEDED STEPS TOWARD THE EVENTUAL REJUVENATION OF THE ECONOMY BUT WHICH ARE NOT LIKELY TO PRODUCE AN EARLY RESURGENCE OF PRIVATE INVESTMENT.

9. CENTRAL GOVERNMENT REVENUES HAVE NOT BEEN KEEPING PACE WITH REQUIREMENTS, FAILING TO EVEN COVER BUDGETED CURRENT EXPENDITURES IN 1976. THUS, A REVENUE (TAX) INCREASE WAS ESSENTIAL TO AVERT A PROBABLE MAJOR CUTBACK OF THE GOP'S INVESTMENT PROGRAM EVEN THOUGH THE DIRECT ECONOMIC IMPACT OF HIGHER TAXES WOULD BE CONTRACTIONARY AT PRECISELY THE TIME WHEN THE ECONOMY NEEDS STIMULATING. THE GOP ESTIMATES THAT THIS PACKAGE OF MOSTLY CONSUMER TAXES WILL YIELD AROUND \$27 MILLION ANNUALLY--ABOUT 10 PERCENT OF CURRENT CENTRAL GOVERNMENT REVENUES-- LIMITED OFFICIAL USE

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OF WHICH \$23 MILLION WOULD COME FROM THE VALUE ADDED TAX. THE REGRESSIVE NATURE OF THE PACKAGE IS SOFTENED SOMEWHAT BY EXEMPTING FOOD AND MEDICINES FROM THE 5 PERCENT TAX AND EXEMPTING INCOMES AT THE LOW END OF THE SCALE FROM THE INCOME TAX. THESE TAXES FOLLOW OTHER RECENT MEASURES TO REDUCE CONSUMPTION AND INCREASE PUBLIC SAVINGS FOR THE LONGER PULL-- HIGHER ELECTRICITY AND TELEPHONE RATES STARTING JANUARY 1 TO ELIMINATE GOVERNMENT SUBSIDIES TO THESE OPERATIONS.

10. THE IMPACT OF THE NEW TAXES ON 1977 CENTRAL GOVERNMENT REVENUES IS PROBABLY OVER ESTIMATED DUE TO THE MAJOR ADMINISTRATIVE TASK OF SETTING UP COLLECTION MACHINERY FOR THE 5 PERCENT TAX, AND THE LAG EFFECT ON REVENUES FROM ANY POSSIBLE ACCELERATION IN 1977 ECONOMIC ACTIVITY. IT IS UNLIKELY THAT COLLECTION PROCEDURES FOR THE 5 PERCENT TAX WILL BE READY BY THE MARCH 1 EFFECTIVE DATE OF THE LAW. NONETHELESS, THERE STILL SHOULD BE AN OVERALL FISCAL IMPROVEMENT THIS YEAR FROM THE COMBINED EFFECT OF INCREASED REVENUES AND THE CENTRAL GOVERNMENT'S EXTREMELY AUSTERE CURRENT OPERATING BUDGET. THIS SHOULD IMPROVE THE GOP'S CREDITWORTHINESS AND RESULT IN SOMEWHAT EASIER EXTERNAL CREDITY AVAILABILITY AND TERMS THAN OTHERWISE WOULD BE THE CASE.

11. THE GOVERNMENT PROBABLY COULD NOT HAVE UNDERTAKEN MUCH MORE AT A SINGLE STROKE TO ENCOURAGE PRIVATE INVESTMENT AND SHIFT RELATIVELY MORE OF THE ECONOMIC BURDEN TO THE CONSUMER SECTOR WITHOUT AROUSING AN UNTENABLE LEVEL OF POLITICAL HOSTILITY. PREDICTABLY, ORGANIZED LABOR AND THE GENERAL CONSUMING PUBLIC REACTED BITTERLY TO THE IMMEDIATE DETERIORATION IN THEIR ECONOMIC SITUATION, AND OF LABOR'S CHERISHED LEGAL RIGHTS VIS-A-VIS MANAGEMENT, AS A RESULT OF THIS OVERALL PACKAGE OF LAWS, BUT

SO FAR NO MASSIVE RESISTANCE--EITHER SPONTANEOUS OR ORGANIZED
HAS TAKEN SHAPE.

12. COMMENT:

A) BY THESE ACTIONSTHE GOP ACKNOWLEDGES THE IMPORTANCE OF THE
PRIVATE SECTOR'S ROLE IN PANAMA'S IMMEDIATE ECONOMIC FUTURE--
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THAT THE GOVERNMENT CAN SUPPLEMENT BUT NOT SUPPLANT PRIVATE
INVESTMENT. THE MEASURES THUS REPRESENT A GOP DETERMINATION
TO REVIVE THE ECONOMY BY RE-ENGAGING PRIVATE BUSINESS INTO THE
ECONOMIC MAINSTREAM DESPITE THE SUBSTANTIAL POLITICAL RISKS
THAT THE EFFORT ENTAILS. THE GOP SEEMS LIKEWISE DETERMINED
TO BEGIN SETTING ITS FISCAL HOUSE IN ORDER THROUGH INCREASED
TAXATION EVEN IN THE FACE OF INTENSIFYING PUBLIC DISCONTENT
WITH THE PRESENT REGIME. THE MESSAGE SHOULD BE CLEAR TO ALL:
THE GOP INTENDS TO CARRY OUT AN ECONOMIC IMPROVEMENT POLICY
WHICH INVOLVES SOME SACRIFICE BY THE GENERAL PUBLIC.
B) HAVING TAKEN SOME DIFFICULT SELF-HELP MEASURES, THE GOP
IS NOW IN A BETTER POSITION TO CLAIM--RIGHTLY OR WRONGLY--
THAT ABSENCE OF A NEW TREATY IS NOW THE ONLY MAJOR OBSTACLE
TO PANAMA'S RENEWED GROWTH AND DEVELOPMENT.

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Message Attributes

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